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FM AMEMBASSY LA PAZ
TO RUEHC/SECSTATE WASHDC PRIORITY 4047
INFO RUEHAC/AMEMBASSY ASUNCION 6876
RUEHSW/AMEMBASSY BERN 0137
RUEHBO/AMEMBASSY BOGOTA 4222
RUEHBR/AMEMBASSY BRASILIA 8105
RUEHBU/AMEMBASSY BUENOS AIRES 5356
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RUMIAAA/USCINCSO MIAMI FL
RHEHNSC/NSC WASHINGTON DC

UNCLAS E F T O LA PAZ 001740

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E.O. 12958: N/A
TAGS: ECON EMIN SENV BL
SUBJECT: UNCERTAINTY IN BOLIVIA'S MINING SECTOR

Classified By: EcoPol Counselor Andrew Erickson for reasons
1.4(b) and (d).

Summary

¶1. (SBU) Proposed changes to the mining code and tax regime worry international and U.S. mining companies in Bolivia. Although the GOB's stated aim is a 50-50 split in profits between the GOB and private companies, the head of the mining association and U.S. company representatives have informed emboff that the actual government take if the proposed changes are passed will be more than 50 percent under reasonable economic assumptions and could rise to 100 percent under certain scenarios. In addition, the GOB is using various tactics to encourage more value added to mining production in Bolivia. The tone of government rhetoric is also raising concerns, especially regarding the role of the Bolivian Mining Company (COMIBOL) as a "partner" in all future operations. Post will meet with executives of the three major U.S. mining companies in the next weeks and will attempt to arrange a courtesy call on the Mining Minister, at which time general industry concerns can be raised. End summary.

Proposed Tax Increases

¶2. (SBU) President Morales' executive branch has submitted to the Bolivian congress a proposal to increase the tax on mine profits from 25 to 37.5 percent when metal prices are over certain levels (currently gold and silver prices are over the proposed levels, and thus the tax increases would take effect immediately upon passage of the legislation.) The proposed tax changes also include the elimination of tax accreditation (currently companies can credit royalties against the tax on

profits.) Mining contacts tell us that the proposed changes will raise their effective tax rates to between 55 percent and 70 percent and that their previous counterproposals seem to have been ignored by the GOB. Humberto Rada, the head of the Bolivian mining association and General Manager of Newmont subsidiary Inti Raymi provided emboff with a series of economic models that show that, under certain conditions, the proposed changes could result in effective tax rates of over 100 percent. To encourage greater refinement of minerals and therefore more value added, the new tax proposal includes an exception that allows companies that refine metals (such as Newmont's Inti Raymi and Coeur D'Alene's San Bartolome) to pay only 60 percent of the proposed 12.5 percent increase in tax on profits. Apex's San Cristobal, which will produce less-processed concentrate, would not benefit from this exception (paragraphs 4 and 5 discuss other GOB tactics to increase value added in Bolivia.) (Note: President Morales has excluded cooperatives from the proposed 12.5 percent tax increase, and they will also be required to pay only 60 percent of royalties.)

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Proposed Changes to Ownership of Mining Concessions
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¶3. (SBU) The current draft of the new mining code also includes changes which will codify President Morales' May 1st decree declaring all mineral reserves to be property of the government. This change would mean that mining companies could not list reserves among their assets nor could they mortgage the concessions. The change would have minimal effect on Coeur's San Bartolome (which leases concessions from cooperatives) and on Newmont's Inti Raymi, which is in the final stages of production. The effect on Apex's San Cristobal, however, could be serious, since the company has mortgaged its concessions to raise money for start-up. At the moment, current concessions are not being affected, but the new draft mining code could eliminate this exception.

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Possible Elimination of Refunds on Import Taxes
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¶4. (SBU) In another worrying potential tax regime change, the Finance Ministry has proposed the elimination of the current CEDOIMS program (in which exporters can claim rebates on taxes paid on imported inputs) for companies who are not exporting "value added" products. Companies that produce metals will still be able to participate under the CEDOIMS program while companies which produce concentrate will not be allowed to claim rebates of their import taxes (note, this will apply to the hydrocarbons and lumber industries as well.) According to mining association president Humberto Rada, only three of the fifteen member companies in his association (including Newmont's Inti Raymi, which produces gold, and Coeur D'Alene's Manquiri, which will produce metallic silver) will still be able to participate in the CEDOIMS program if this change takes place. Apex's San Cristobal plans to export concentrate and therefore would not be able to claim rebates. San Cristobal executives have explained that they have years' worth of back claims which will not be paid by the GOB until San Cristobal starts exporting (and, should this new law pass, might therefore never be paid.) San Cristobal Corporate Vice President Gerardo Garrett states that he does not expect the elimination of CEDOIMS any time this year, but that if it does occur, it will "kill San Cristobal" and that it is a greater threat than the potential tax increases.

¶5. (SBU) The GOB's push to encourage more value-added in the mining industry faces an uphill battle. The GOB has pressed Apex's San Cristobal in the past to build a smelter, but Bolivia is not an attractive option for a smelter due to transportation difficulties both for the raw input and the finished products, which would include sulfuric acid (a byproduct of zinc smelting.) The start-up time for a smelter would be approximately five years, and building a smelter would not be a good economic decision for Apex (which also

rejected as unfeasible the possibility of refitting COMIBOL's Karachipampa lead-silver smelter, built in 1983 at a cost of approximately USD200 million and never fired.)

Nationalization Worries

¶6. (SBU) Although the GOB's current rhetoric focuses on "partnerships" between private companies and the GOB (i.e. COMIBOL), some observers suggest that nationalization could be a threat in the future. For example, when asked about the possibility of nationalization for Newmont's Inti Raymi operation, Humberto Rada explained that the mining situation at Inti Raymi (which has a very low-grade and complex ore) means that the operation is not an attractive prospect for nationalization, since COMIBOL does not have the expertise to run such a mine. He warned that an operation like San Cristobal, with high-grade ore and extensive reserves might be more appealing. According to Rada, San Cristobal has signed the mining association's letters of protest to the GOB, but in general is trying to keep a low profile and not confront the GOB because they have "everything to lose." San Cristobal vice president Garrett confirmed that the company

does not want to engage in threats or bluster, because they have very few options since they are fully invested in Bolivia. He also informed emboff that after a mistaken declaration of intent to nationalize in May of 2006 by the former Mining Minister, San Cristobal received assurances from the Morales government that in fact no nationalization was planned for San Cristobal. Garrett cautioned that if changes to the mining law require 50-50 joint ventures with COMIBOL, nationalization could be the de facto result if Apex can not arrange a viable joint-venture contract.

Wooing the GOB with ATPDEA and other tactics

¶7. (SBU) In such a unstable and unpredictable political environment, US companies are looking for new ways to encourage reasonable decisions on the part of the GOB. In a meeting on June 15, a top official of Coeur d'Alene subsidiary Manquiri informed emboff that Coeur d'Alene is working its ties in the U.S. Congress to push for extension of ATPDEA. Meanwhile, Apex is trying to leverage the goodwill between Bolivia and Japan by approaching the GOB through its Japanese partner Sumitomo (San Cristobal executives report that their Japanese partners are having little success, and that Sumitomo has within the last few days sent a letter to President Morales asking, diplomatically, why the GOB is not living up to the promises it made during Morales' visit to Tokyo.) Newmont seems to be relying on the fact that the Inti Raymi deposit is too complex and low-grade for the GOB to want it, and they are also encouraging the GOB's focus on value added since they already produce metallic gold. All three companies report difficulties in arranging meetings with the Mining Minister (San Cristobal executives say they don't even get responses to their requests any more.)

Comment

¶8. (SBU) Although the proposed tax regime and mining code changes have yet to be approved by congress and could still be modified, there is a sense of tense anticipation in the international mining community in Bolivia. The GOB's heavy-handed attempts to manage the economy through differential tax regimes create an environment which is far more negative for some projects (such as Apex's San Cristobal) than others. The nationalization of Swiss-based Glencore's Vinto smelter serves as a warning of potential future threats to US assets, although the GOB currently claims that all it wants is an "equitable" 50-50 share of profits and "partnership" status with mining companies.

Executives of the three major U.S. mining concerns in Bolivia will soon meet with the Ambassador. Subsequently, the Ambassador may call on Mining Minister Echazu. Emboff has visited Coeur's San Bartolome project in the past weeks, will visit Newmont's Inti Raymi June 28, and is arranging a visit to Apex's San Cristobal as soon as possible. Ecopol will also meet with Mining Ministry and COMIBOL officials. End comment.
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